

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 97- 49**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Nexus for corporate franchise, excise taxes of a limited partnership, in state general partner, and foreign limited partner.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[THE TAXPAYER] is incorporated and commercially domiciled in [STATE A - NOT TENNESSEE]. The Taxpayer owns stock in a number of subsidiaries. The Taxpayer has residential real estate construction operations in [STATE A], Tennessee, and other states.

The Taxpayer is considering conducting its Tennessee operation through a limited partnership.

The Taxpayer will form [CORPORATION 1], a Delaware corporation, which in turn will form [CORPORATION 2], a Delaware corporation. The Taxpayer will contribute its Tennessee residential real estate construction operation to [CORPORATION 1]. [CORPORATION 1] and [CORPORATION 2] will simultaneously form [PARTNERSHIP X], a Tennessee limited partnership. [CORPORATION 1] will contribute its Tennessee residential real estate construction operations to [PARTNERSHIP X] in exchange for a 99% limited partnership interest. [CORPORATION 2] will contribute cash to the partnership necessary to provide it with a 1% general partnership interest.

[CORPORATION 2] will conduct its management activities of [PARTNERSHIP X] both from its corporate headquarters in [STATE A], as well as from its office in Tennessee. [CORPORATION 2], as the general partner and a foreign corporation doing business in Tennessee, will be subject to Tennessee corporate franchise, excise taxes. It may contract with [CORPORATION 1] for it to provide certain services for [PARTNERSHIP X]. [CORPORATION 1] will be solely a passive investor in [PARTNERSHIP X]. [CORPORATION 1] will exercise no power or control over [PARTNERSHIP X] and will not participate in the management of [PARTNERSHIP X] in any way. [CORPORATION 1] will maintain its commercial domicile in [STATE A] and will have no connection with Tennessee other than its limited partnership interest in [PARTNERSHIP X]. [CORPORATION 1] will neither be incorporated nor qualified to do business in Tennessee.

ISSUES

1. Whether [PARTNERSHIP X] will be subject to Tennessee corporate franchise, excise taxes.
2. Whether [CORPORATION 1]'s ownership interest as a limited partner in the limited partnership will create sufficient nexus in Tennessee to subject [CORPORATION 1] to Tennessee corporate franchise, excise taxes.
3. How [CORPORATION 2] will report its pro rata share of [PARTNERSHIP X]'s business operations for Tennessee corporate franchise, excise taxes.
4. If [CORPORATION 1] is subject to Tennessee corporate franchise, excise taxes, how the corporate partner will report its pro rata share of [PARTNERSHIP X]'s business operations.

RULINGS

1. [PARTNERSHIP X] will not be subject to Tennessee corporate franchise, excise taxes.
2. [CORPORATION 1]'s ownership interest as a limited partner in the limited partnership will not create sufficient nexus in Tennessee to subject [CORPORATION 1] to Tennessee corporate franchise, excise taxes.
3. [CORPORATION 2]'s ownership share of [PARTNERSHIP X]'s net earnings must be included in the corporation's net earnings subject to apportionment for excise tax purposes. In addition, depending on the applicable subitems in Tenn. Code Ann. § 67-4-906(a)(7), [CORPORATION 2] must include its ownership share of [PARTNERSHIP X]'s real or tangible property, or its capital account shown on the partnership's books and records, in its franchise tax minimum measure. [CORPORATION 2] must include its ownership share of partnership property, payroll and sales in its apportionment formula to determine the proper ratio to apportion net worth and net earnings to Tennessee.
4. Not applicable since [CORPORATION 1] will not be subject to Tennessee corporate franchise, excise taxes.

ANALYSIS

1. Tenn. Code Ann. §§ 67-4-806(a) and 67-4-903(a) impose Tennessee corporate franchise, excise taxes as follows:

(a) All corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee and including state chartered savings and loan associations and federally chartered savings and loan associations doing business in Tennessee shall, without exception other than as provided herein, pay to the commissioner of revenue, annually, an excise tax, in addition to all other taxes, equal to six percent (6%) of the net earnings for the next preceding fiscal year for business done in this state.

(a) All corporations, cooperatives, joint-stock associations and business trusts, including regulated investment companies and real estate investment trusts, organized for profit under the laws of this state or any other state or country and doing business in Tennessee, including state chartered banks and national banks doing business in Tennessee shall, without exception other than as provided herein, pay to the

commissioner of revenue annually a privilege tax in addition to all other taxes, the rate and measure of which are hereinafter set forth. The tax shall be paid for the privilege of engaging in business in corporate form in this state and shall be in addition to all other taxes levied by any other statute.

Partnerships are not among the business entities upon which Tennessee franchise, excise taxes are imposed. Therefore, [PARTNERSHIP X] is not subject to Tennessee franchise, excise taxes.

2. The Department has taken the position that a foreign corporate limited partner is not doing business in Tennessee so as to be subject to Tennessee corporate franchise, excise taxes if:

- (1) The corporate limited partner's only business activity in Tennessee is the holding of a limited partnership interest in a partnership(s) with nexus in Tennessee; and
- (2) The corporate limited partner exercises no power, management or control over the partnership(s) except such powers or capacities outlined in Tenn. Code Ann. § 61-2-302 which limited partners may exercise without participating in the management or control of a partnership.

A foreign corporate limited partner's involvement in a partnership doing business in Tennessee appears to be similar to the interest of a foreign corporation whose only Tennessee activity is that of a stockholder in a corporation doing business in Tennessee. Neither the limited partner nor the stockholder have the right to participate in the management or control of the partnership, or corporation, as the case may be, and thus neither are said to be "doing business" in Tennessee so as to be subject to corporate franchise, excise taxes imposed by Tenn. Code Ann. §§ 67-4-901 et seq. and 67-4-801 et seq. The Department's position is that a foreign corporate limited partner in a partnership has nexus in Tennessee arising only from a passive investment in Tennessee just as a foreign corporate stockholder in a corporation has nexus in Tennessee. Such a passive investment would not create sufficient tax nexus for Tennessee to impose corporate franchise, excise taxes.

It would be possible for a foreign corporate limited partner in a partnership having nexus in Tennessee to engage in other transactions in Tennessee, either with the limited partnership itself, or with other parties, which would result in sufficient Tennessee minimum contacts to subject it to corporate franchise, excise taxes. For example, such a foreign corporate limited partner which also has a general partnership interest in a partnership with Tennessee nexus, or which also has Tennessee activities which are not protected by Title 15 U.S.C.A. §§ 381-384, would be subject to Tennessee franchise, excise taxes.

Under the facts presented, [CORPORATION 1]'s only activity in Tennessee appears to be a limited partnership interest in a Tennessee partnership. Accordingly, [CORPORATION 1] is not subject to Tennessee corporate franchise, excise taxes and is not required to file franchise, excise tax returns with this Department.

3. Tenn. Code Ann. § 67-4-805(a)(1) states the following provisions concerning the computation of a corporation's net earnings for Tennessee excise tax purposes:

(a) (1) Except as provided in subdivision (a)(2) or (3), "net earnings" is defined as federal taxable income before the operating loss deduction and special deductions provided for in 26 U.S.C. §§ 241-247 and 249-250, and subject to the adjustments in subsection (b).

Under Tenn. Code Ann. § 67-4-805(a)(1), the starting point for computing [CORPORATION 2]'s net earnings for Tennessee excise tax purposes is federal taxable income before the net operating loss deduction and special deductions. Income from [CORPORATION 2]'s general partnership interest in [PARTNERSHIP X] would be included in the corporation's federal taxable income. Since adjustments in subsection (b) of Tenn. Code Ann. § 67-4-805 do not operate to remove [CORPORATION 2]'s partnership income from federal net earnings, such income is included in net earnings subject to apportionment for Tennessee excise tax purposes.

Tenn. Code Ann. § 67-4-906(a)(1), (3) and (7)(A), (B), (C) and (D) make the following provisions concerning the treatment of partnership property for purposes of a corporation's franchise tax minimum measure:

(a)(1) The measure of the tax hereby imposed shall in no case be less than the actual value of the property owned, or property used, in Tennessee, excluding exempt inventory.

(3) In cases where part or all of the property is rented, the actual value of property will be deemed to be the book value of all property owned as shown by the books and records of such corporation at the close of its last fiscal year preceding the making of the sworn report hereinafter required (excepting books with respect to investment costs kept pursuant to regulations of the interstate commerce commission), plus the value of the rental property used which shall be determined by multiplying the net annual rental by the following multiples:

	Multiples
(A) Real property	8
(B) Machinery and equipment used in manufacturing and processing	3
(C) Furniture, office machinery and equipment	2
(D) Delivery of mobile equipment	1

(7)(A) For purposes of this section, "property" includes a corporate partner's share of any specific partnership property. The value of such partnership property shall be book value (cost less depreciation) as shown on the partnership books.

(B) The provisions of subdivision (a)(7)(A) shall not, however, apply to corporate partners when the specific partnership property is made up of at least eighty percent (80%) real estate (including, but not limited to, apartments, shopping centers, office buildings, hotels, and motels) which is either leased, rented, offered or held for sale, lease or rental to the public in the ordinary course of business.

(C) Notwithstanding the provisions of subdivision (a)(7)(B), the provisions of subdivision (a)(7)(A) shall apply to any partnership property which is occupied by the corporate partner in its trade or business.

(D) The provisions of subdivision (a)(7)(A) shall only apply, however, if the combined annual payroll and book value of the property of the partnership exceeds one million five hundred thousand dollars (\$1,500,000).

If [PARTNERSHIP X] is not a real estate investment partnership under the provisions of Tenn. Code Ann. § 67-4-906(a)(7)(B) and (C), and if its combined annual payroll and book value of property exceed \$1,500,000, [CORPORATION 2] must include its ownership share of the book value of the partnership's Tennessee real and tangible personal property, whether owned or rented from other parties, in its franchise tax minimum measure.

In the event [PARTNERSHIP X] is a real estate investment partnership under the provisions of Tenn. Code Ann. § 67-4-906(a)(7)(B) and (C), or if its combined annual payroll and book value of property are \$1,500,000 or less, then [CORPORATION 2] need not include its ownership share of the book value of the partnership's owned or rented Tennessee real and tangible personal property in its franchise tax minimum measure. In such a case, the Tennessee Supreme Court decision in *Omnicon, Inc. v. King*, 688 S.W.2d 818 (Tenn. 1985), applies and [CORPORATION 2] must include in its franchise tax minimum measure its corporate partnership capital account as shown on the partnership's books and records kept in accordance with generally accepted accounting principles.

When a foreign corporate partner, whether general or limited, has nexus in Tennessee and is also doing business outside Tennessee, the corporation must compute an apportionment formula for corporate franchise, excise tax purposes under Tenn. Code Ann. §§ 67-4-910 and 67-4-811. These statutes state that corporate net worth and net earnings shall be apportioned to Tennessee by an average ratio of corporate property, payroll and sales in Tennessee to property, payroll and sales everywhere.

For purposes of computing such an apportionment formula, Tenn. Code Ann. §§ 67-4-910(b)(2), (e)(3) and (g)(2) and 67-4-811(b)(2), (e)(2) and (g)(2) provide that, in franchise, excise tax apportionment statutes, the terms "property", "payroll" and "sales"

include a corporate partner's share of the partnership's property, payroll and sales. Thus, when a corporate partner computes an apportionment formula on its franchise, excise tax return to apportion net worth and net earnings to Tennessee, it must include in the formula its ownership share of the partnership's property, payroll and sales.

Under the facts presented, [CORPORATION 2] has nexus in Tennessee as a result of its general partnership interest and, when filing its franchise, excise tax return, it must include its ownership share of partnership property, payroll and sales in its apportionment formula to determine the proper ratio to apportion net worth and net earnings to Tennessee.

4. An analysis of the last issue is unnecessary because, as stated above, [CORPORATION 1] will not be subject to Tennessee corporate franchise, excise taxes.

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APPROVED: Ruth E. Johnson
Commissioner

DATE: 12/2/97